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61867—38

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 912

JAMES E. DAVIDSON, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 10–22) is reported at 34 B. T. A. 555. The opinion of the Circuit Court of Appeals (R. 35–40) is reported at 94 F. (2d) 300.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 31, 1938 (R. 40–41). A petition for rehearing was denied February 22, 1938 (R. 42). The petition for writ of certiorari was filed April 1, 1938. The jurisdiction of this

Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxable gain from the sale of 1,000 shares of certain stock is to be determined, as the Board and the court below held, upon the basis of the cost of the shares which the taxpayer actually sold, as represented by the certificates actually delivered to the broker by a bank (through a mistake of the bank), which certificates have been identified, rather than, as the taxpayer claims, upon the basis of the cost of the shares which he intended to sell and instructed the bank to deliver and the broker to sell.

STATUTE INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.
>
> (a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.
>
> * * * * *
>
> SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.
>
> (a) *Property acquired after February 28, 1913.*—The basis for determining the gain or

loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *

* * * * *

STATEMENT

The facts relevant to the question here presented, as found by the Board,[1] may be stated as follows (R. 14):

On March 27, 1929, the taxpayer, through his broker, purchased 1,000 shares of National Power & Light Company stock with a part of the proceeds of a loan from the Omaha National Bank, certificates for which, numbered 80,250 to 80,258, inclusive, and 80,264, were delivered to the taxpayer and were put up as collateral with the bank (R. 14).

On June 19, 1929, the taxpayer instructed his broker to sell 500 of the 1,000 shares purchased on March 27, 1929, the certificates for which were on deposit at the bank. When the sale was made the taxpayer called at the bank to get the certificates for delivery to the broker, but the bank refused to release them to the taxpayer, stating that it would make delivery itself. The taxpayer then instructed the bank to deliver 500 shares from the certificates numbered 80,250 to 80,258, inclusive,

[1] The opinion of the Board (R. 10–22) covering both this case and a companion case in which the taxpayer's wife is the taxpayer and the petitioner in *Edith L. Davidson* v. *Commissioner*, No. 913 in this Court, contains the relevant facts under that portion of the Board's findings of fact headed "National Power & Light Co. transactions of James E. Davidson in 1929" (R. 13–14).

and 80,264. In making delivery, however, a bank clerk, by mistake, delivered certificates from another lot which had been held as collateral by the bank since 1925. The mistake was not known to the taxpayer at that time (R. 14).

On July 1, 1929, the taxpayer instructed the broker to sell the remaining 500 shares purchased on March 27, 1929, and instructed the bank to deliver to the broker the remaining 500 shares from the certificates above mentioned. Again, however, the bank made the same mistake and delivered to the broker certificates for 500 shares from the lot which had been held as collateral since 1925 (R. 14).

The aggregate proceeds from the sale of these 1,000 shares were $59,435. The cost of the 1,000 shares purchased on March 27, 1929, was $49,900. The cost of the 1,000 shares which were delivered to the broker by mistake was $4,420 (R. 14).

In his return, and in his appeals to the Board (R. 3–5) and to the court below (R. 25–29), the taxpayer claimed that his gain should be computed upon the basis of the cost of the 1,000 shares which he intended to sell. The Board of Tax Appeals held (R. 18–20) that the shares delivered to the broker were the shares actually sold by the taxpayer, and that the taxable gain is to be determined upon the basis of the cost of the shares represented by the certificates which were actually delivered to the broker. The court below affirmed the decision of the Board (R. 35–40).

DISCUSSION

The court below recognized that its decision is in conflict with "the broad holding" of the Circuit Court of Appeals for the Second Circuit in *Miller* v. *Commissioner,* 80 F. (2d) 219. The conflict is the result of differing interpretations of this Court's opinion in *Helvering* v. *Rankin,* 295 U. S. 123. We believe that the decision of the court below is correct and that the court in the *Miller* case misconceived the meaning of this Court's decision in *Helvering* v. *Rankin, supra.* While the *Miller* case is perhaps distinguishable from the present case, on the ground hereafter stated, we do not, in view of the undoubted inconsistency in the interpretations of this Court's opinion in the *Rankin* case, oppose the grant of a writ of certiorari herein.

In the present case, although the taxpayer's intention was to sell the 1,000 shares acquired on March 27, 1929, at a cost of $49,900, and although he so instructed his broker and later instructed the bank to deliver to the broker those specific shares, what actually took place was that in consummation of the sale 1,000 other shares, which have been identified as shares bought on a prior date at a cost of $4,420, were delivered to the broker and were sold. Controversy, therefore, centers upon the effect to be given to the taxpayer's intention, where that intention was not carried out in consummating the sale. Admittedly, the failure to carry out that intention was due to a mistake of the bank, or

of the bank clerk. But other shares were, in fact, actually sold, as represented by the certificates delivered by the bank, which, as suggested in both opinions below (R. 20, 39), must be regarded as the taxpayer's agent (at least for the purposes of the present controversy). Under the circumstances, the court below correctly held that the tax liability must be determined by what in fact was done. *United States* v. *Phellis*, 257 U. S. 156, 172; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 98; *Bonham* v. *Commissioner*, 89 F. (2d) 725, 728 (C. C. A. 8th); *Curtis* v. *Commissioner*, 89 F. (2d) 736, 738 (C. C. A. 8th); *Remington Rand, Inc.*, v. *Commissioner*, 33 F. (2d) 77, 78 (C. C. A. 2d).

The decision below is in keeping with the principles laid down in *Curtis* v. *Commissioner*, *supra*; *Vawter* v. *Commissioner*, 83 F. (2d) 11 (C. C. A. 10th), certiorari denied, 299 U. S. 578; *Horner* v. *Commissioner*, 72 F. (2d) 407 (C. C. A. 3d); *Commissioner* v. *Merchants' & Mfrs.' F. Ins. Co.*, 72 F. (2d) 408 (C. C. A. 3d); *Cole* v. *Helburn*, 4 F. Supp. 230 (W. D. Ky.); *Skinner* v. *Eaton*, 45 F. (2d) 568 (C. C. A. 2d), certiorari denied, 283 U. S. 837; *Horner* v. *Commissioner*, 78 F. (2d) 813 (C. C. A. 3d).

We think that the court below was clearly correct in holding that a decision in favor of the taxpayer was not required by this Court's decision in *Helvering* v. *Rankin*, *supra*. In that case the tax-

payer had been trading in stocks on a marginal account and identification by certificates was impossible. The case holds only that identification by certificate is not the only means of identification, and that, where that is impossible, the taxpayer may resort to identification by dates or cost of purchases in a communication or selling instruction to the broker so as to avoid the application of the so-called "first in, first out" rule. Of course, there is no question of the application of that rule here, because the shares sold have been definitely identified. For the same reason, as the court below properly recognized, there is no occasion for resort to selling instructions.

In *Miller* v. *Commissioner, supra,* where stock was in the possession of the broker, the taxpayer in a communication to the broker directed him to sell certain shares purchased on certain dates, but in consummating the sale the broker delivered certificates representing other shares. The court there came to the conclusion (p. 221):

> * * * that a designation by instructions to the broker of the shares to be sold is controlling though the certificate delivered does not correspond with the instructions; * * *

This holding, we think, represents a misconception of the *Rankin* case. That case, far from holding that a designation by instructions to the broker is controlling, recognized that identification by certificate is the ordinary, and the best, means of

identification, and that other means are permissible only where identification by certificate is not possible.

While the broad holding of the *Miller* case as quoted above is thus in conflict with the holding below, it should be pointed out that upon the particular facts of the two cases a distinction exists. In the *Miller* case, the shares were already in the possession of the broker when the instructions to sell were given, whereas in the present case they were in the possession of the taxpayer's agent, the bank, and so remained subject to the taxpayer's control. This distinction, which the court below recognized (R. 39), and which the Board held to be controlling (R. 19), is suggested even by the *Miller* case, where the court, in speaking of some of the cases hereinabove referred to, said (p. 221):

> But in each of these cases the taxpayer himself had custody of the certificates * * *.

The same distinction applies to *Millikan* v. *Commissioner*, 83 F. (2d) 213 (C. C. A. 2d), cited in the petition, where the certificates were likewise in the possession of the broker.

The petitioner's assertion of conflict with other decisions of the circuit courts of appeals (Pet. 4–5) is without merit. *Fuller* v. *Commissioner*, 81 F. (2d) 176 (C. C. A. 1st), and *Kraus* v. *Commissioner*, 88 F. (2d) 616 (C. C. A. 2d), are distinguishable in that they involved situations where identification by certificates was impossible be-

cause the shares held by the taxpayer had been exchanged for new shares in a nontaxable exchange. *Howbert* v. *Pennrose*, 38 F. (2d) 577 (C. C. A. 10th), is distinguishable from the instant case because there it was found *as a fact* that the shares the taxpayer intended to sell were actually sold, as the appellate court pointed out (p. 578):

> The trial court found as a fact from the evidence, that "plaintiff intended to *and did sell*" the shares acquired in 1916 and 1917. [Italics supplied.]

CONCLUSION

While we believe that the court below correctly applied the statute to the facts of this case, we do not oppose the grant of certiorari in view of the conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Miller* v. *Commissioner, supra.*

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